Sharekhan by BNP PARIBAS

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Stock Update

Zee Entertainment Enterprises Ltd

Making the right move

Consumer Discretionary		Sharekhan code: ZEEL		
Reco/View: Buy	⇔	CMP: **Rs. 349**	Price Target: **Rs. 400**	⇔

↑ Upgrade ⇔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)		✓	
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		⇔	
RQ		⇔	
RV		⇔	

ESG Disclosure Score NEW

ESG RISK RATING	16.20
Updated Oct 08, 2021	

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 33,493 cr
52-week high/low:	Rs. 378 / 166
NSE volume: (No of shares)	225.5 lakh
BSE code:	505537
NSE code:	ZEEL
Free float: (No of shares)	92.2 cr

Shareholding (%)

Promoters	4.0
FII	67.9
DII	17.9
Others	10.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	16.7	3.4	61.1	62.5
Relative to Sensex	19.3	6.8	52.3	38.8

Sharekhan Research, Bloomberg

Summary

- ZEEL and SPNI have signed the binding agreement to merge themselves. The deal structure remains in-line with the earlier announcement, where SPNI will hold 50.86% stake of the merged entity.
- This would likely strengthen the combined entity's market position and create a scalable business proposition for the OTT business. Management expects synergy benefits of 6-8%, largely from revenue.
- ZEEL's promotors have option to increase their stake from 3.99% to 20%. The stake's purchase must be from the open market, which would address investor concerns.
- We maintain Buy with an unchanged PT of Rs. 400. Growth capital would be used to accelerate its OTT, movies, and premier content including sports rights.

ZEE Entertainment Limited's (ZEEL's) board has signed the binding agreement with Sony Pictures Networks India (SPNI) to combine their linear networks, digital assets, production operations, and program libraries. The structure of the deal remains mostly in-line with the earlier announcement, where SPNI will hold 50.86% stake of the merged entity and ZEEL's promoter will own 3.99% stake. The deal will go through many regulatory approvals and the entire merger process is expected to be closed in the next 8-10 months. The combined entity will be in a superior position to maximise revenue across its platforms, given its reach potential and availability of growth capital ($1.5 billion from SPNI) for the M&A activity in the digital space and aggressive bidding for premium content such as sports.

- **SPNI's infusion of growth capital into combined entity:** There will be Rs. 9,050 crore fresh capital infusion into the merged entity, including Rs. 7,948.7 crore through the rights issue to SPNI shareholders and Rs. 1,101.3 crore by ZEEL's promoter. The total fresh capital infusion (Rs. 9,050 crore, i.e., $1.2 billion) and existing cash in the balance sheet of SPNI will form the growth capital ($1.5 billion) at the closing. This growth capital will be used for the M&A activity in the digital space and bringing premium content.
- **Leverage Sony Group's capability to drive growth:** We believe the merged entity will drive the scale in terms of revenue by leveraging ZEEL's strong presence in regional markets and Sony group's strong understanding of the global media landscape and innovative technology-led solutions. Management indicated that the merged entity would have 6-8% synergy led by revenue. On the OTT front, the combined entity would able to compete with leading streaming players by aggressively bidding sports rights and levering Sony Group's strength in the gaming space.
- **ZEEL's promotors to limit holdings to 20%:** ZEEL's promoter holdings in the merged entity will be limited to 20%. Further, this construct does not provide ZEEL's promoter any pre-emptive or other rights to acquire equity of the combined company from the Sony Group, the combined company or any other party. Hence, we believe the stake increase by ZEEL's promoter would be market linked.

Our Call

Valuation: Merger to improve long-term prospects: We believe the merger will strengthen the market position of the combined entity and help to grow OTT at a faster pace by allocating growth capital towards premium content, including sports rights. Further, the strong board and proven operational track record of Mr. Puneet Goenka will enhance the combined entity's competitive position in markets, which would drive its revenue and profitability as well. We believe corporate governance concerns will get addressed with the controlling stake of SPNI. The stock is currently trading at a reasonable valuation at 21x/19x its FY2023E/FY2024E earnings. The stock price of ZEEL has provided a return of 104% over the past four months. Hence, we maintain our Buy rating on ZEEL with an unchanged price target (PT) of Rs. 400.

Key Risks

1) A slowdown in the economy leading to lower demand and subdued realisation for advertisement revenue stream and 2) delay in monetisation benefit from digitisation and a higher content cost could affect earnings.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	7,729.9	8,335.6	9,369.5	10,204.4
OPM (%)	23.2	23.0	24.8	25.1
Adjusted PAT	1,122.9	1,302.9	1,604.5	1,759.1
% YoY growth	*123.8*	*16.0*	*23.1*	*9.6*
Adjusted EPS (Rs.)	11.7	13.6	16.7	18.3
P/E (x)	26.9	23.1	18.8	17.1
P/B (x)	3.0	2.7	2.5	2.2
EV/EBITDA (x)	16.4	14.2	11.3	9.8
RoNW (%)	11.1	11.8	13.0	12.9
RoCE (%)	14.7	14.9	16.8	16.8

Source: Company; Sharekhan estimates

Event: Board approves binding agreement with SPNI

After three months of due diligence, ZEEL's board has finally signed the binding agreement with SPNI to merge ZEEL with and into SPNI and combine their linear networks, digital assets, production operations, and program libraries. The structure of the deal remains mostly in-line with the earlier announcement (SPNI would invest $1.575 billion and hold 52.93% stake in the merged entity). As per the current deal structure, SPNI will own 50.86% stake of the merged entity and appoint a majority of directors, while the promoter group of ZEEL will own 3.99% stake and public shareholders will own 45.15% stake. Further, the number of shares will increase to 173.63 crore from the current base of 96.05 crore after the transaction.

The merger is between ZEEL, Bangla Entertainment Private Limited (BEPL) and SPNI. As per the scheme of arrangement, the merger will be a combination of bonus shares and subdivision of shares to SPNI shareholders, equity issue to SPNI via rights issue, equity infusion (i.e., non-compete fee from SPNI) from ZEEL's promoters to SPNI, share swap of 85:100 for ZEEL's shareholders and share swap of 133:100 for BEPL's shareholders.

- **SPNI's Infusion of growth capital of $1.5 billion into the combined entity:** Under the terms of the definitive agreements, SPNI will have cash balance of $1.5 billion (Rs. 113 billion) at closing, including through infusion of $1.2 billion by the current shareholders of SPNI and the promoter founders of ZEEL. There will be Rs. 9,050 crore fresh capital infusion by SPNI, including Rs. 7,948.7 crore through 26.5 rights issue to SPNI shareholders and Rs. 1,101.3 crore by ZEEL's promoter though 3.67 core new share issues. SPNI will pay non-compete fees of Rs. 1,101.3 crore to ZEEL's promoters. The total fresh capital infusion (Rs. 9,050 crore) and existing cash and cash equivalents in the balance sheet of SPNI will form the growth capital ($1.5 billion). The cash and cash equivalents of around $200 million (Rs. 1.6 billion) in ZEEL's book will be on and above SPNI's growth capital.
- **SPNI to fund addition stake of ZEEL's promoters:** SPE Mauritius Investments will pay non-compete fees of Rs. 1,101.3 crore to Eyssel Mauritius. ZEEL's promoter will use the non-compete fees for acquiring 3.67 crore shares of SPNI (translates to Rs. 300 per share). This infusion of capital will help ZEEL's promoter to raise its stake in the merged entity by 2.11% to 3.99%.
- **ZEEL's promotors to limit holdings to 20% of the merged entity:** ZEEL's promoter has agreed to limit its stake to 20% in the combined company. This construct does not provide ZEEL's promoter any pre-emptive or other rights to acquire equity of the combined company from the Sony Group, the combined company or any other party. Any shares purchased by the promoters (founders) of ZEEL must be in compliance with all applicable laws, including any pricing guidelines.
- **Board members to be nominated by Sony Group; Appointment of MD and CEO:** Essel Group will be considered as the promoter of the combined entity. Mr. Punit Goenka will lead the combined company as its MD and CEO. The majority of the board of directors of the combined company will be nominated by Sony Group and will include the current SPNI MD and CEO, Mr. N.P. Singh.
- **Regulatory approvals and timeline:** ZEEL's management indicated that both ZEEL and SPNI will file joint application with the Competition Commission of India (CCI) and then file the scheme documents with SEBI and stock exchanges. Post the approval, both the companies will process application with the NCLT for the merger process. The merger will also require approval from the Ministry of Information and Broadcasting (MIB). The company will also approach to shareholders for getting their approvals as it requires 75% votes of total shareholders. The listing of shares will get suspended for three weeks after NCLT's approval. The entire merger process is expected to be closed in the next 8-10 months.

Change in shareholding pattern in the combined entity

	Current shareholdings		Post the transaction	
	Shares (crore)	% of total	Shares (crore)	% of total
Sony	-	-	88.3	50.86
ZEEL's promoters	3.8	3.99	6.9	3.99
Public	92.2	96.01	78.4	45.15
Total	96.1	100.00	173.6	100.00

Source: Company

A strategic fit

The merger will create the largest media and entertainment (M&E) company in India across languages and genres. SPNI is strong in Hindi GEC segment and sports, where ZEEL has edge in the regional GEC markets and Hindi movies space (even Sony has a strong movie catalogue). Hence, the merged entity is expected to bring some rationalisation in the Hindi movie space and will have a wide portfolio, including general entertainment, sports, comedy, English movies. SPNI currently operates 26 channels, while ZEEL has 49 channels. We believe the merged entity will drive the scale in terms of revenue by leveraging ZEEL's strong presence in domestic markets and Sony Group's strong understanding of the global media landscape and innovative technology-led solutions. Further, the combined entity will derive better growth in advertising revenue because of their leading TV viewership share. Management indicated that the merged entity would have 6-8% synergy led by revenue. On the OTT front, the combined entity would be able to compete with leading streaming players by introducing sports and gaming to its portfolio apart from bringing wider content choices to the platform.

Key conference call highlights

- **Operate independently till the merger happens:** Management stated that both the companies will operate independently till the merger process is completed.
- **Movie rights:** Management indicated that there will not be any material impact relating to bidding war of movie rights because of this consolidation. However, management will try to bring some rationality in the bidding process of movie rights.
- **Brand merger:** The board of the merged entity will decide on the brand's merger. However, management believes that both the brands are strong brands in the market.
- **OTT consolidation:** ZEEL's management indicated that it will consider the consolidation on the OTT front. However, both the entities have not started discussion on this yet. The board of the merged entity will take decision on the consolidation of the OTT.
- **Related-party transactions:** Some of the related-party transactions will be resolved before the transaction and some transactions relating to continuity of business will continue in the books post the merger.
- **Combined entity will lead in revenue among peers in India:** The proposed merged entity would become the largest M&E player in India and become the market leader across genres and languages. It would command a significant market share in the linear space and will have around $2 billion in revenue. Management indicated that the merged entity will be the most profitable media business in terms of EBITDA margin across the world.
- **Leading viewership market share:** The merged entity's TV viewership market share will touch 33%, which will be higher than Star India.
- **Commentary on dividend:** The company intends to remain as a dividend paying company going forward.
- **Excluded Sony's music and movie production business in the transaction:** Sony's music and movie production business will not be included in the merged entity. However, ZEEL's music and movie production business will be included in the combined entity.
- **Growth capital:** The infusion of growth capital ($1.5 billion) in the combined company will help to drive scale by investing in digital assets, sports, and premium content. The capital can be used for M&A activity in the digital space and bringing premium content such as sports. Capital allocation will be decided by the new combined entity's board.
- **Revenue and cost synergies:** Management believes that overall synergies would be to the extent of 6-8% led by revenue, which can be materialised in the first year of operations. There will be less synergy in the cost side as there is minimal overlap of channels in their portfolios.
- **Significant difference in content amortisation policy:** Management stated that there is significant difference in the content amortisation policy between ZEEL and SPNI, especially in relation to amortisation of the movie content.

Outlook and Valuation

■ Sector view - Advertising growth recovery likely to remain strong

As per a KPMG report, the Indian M&E industry's growth would be significantly impacted in FY2021 owing to nationwide lockdown restrictions because of the pandemic, slowdown in advertising spends, and breaking down of content supply chains. However, the M&E sector is expected to bounce back in FY2022 with 33.1% y-o-y growth to reach Rs. 1.86 trillion. The television segment is expected to revert to 8.6% y-o-y in FY2022 on account of strong 19% growth in ad revenue and 4% growth in subscription revenue. We expect television as a medium to continue to stay relevant and the most preferred choice for advertisers, given its reach to the mass audience.

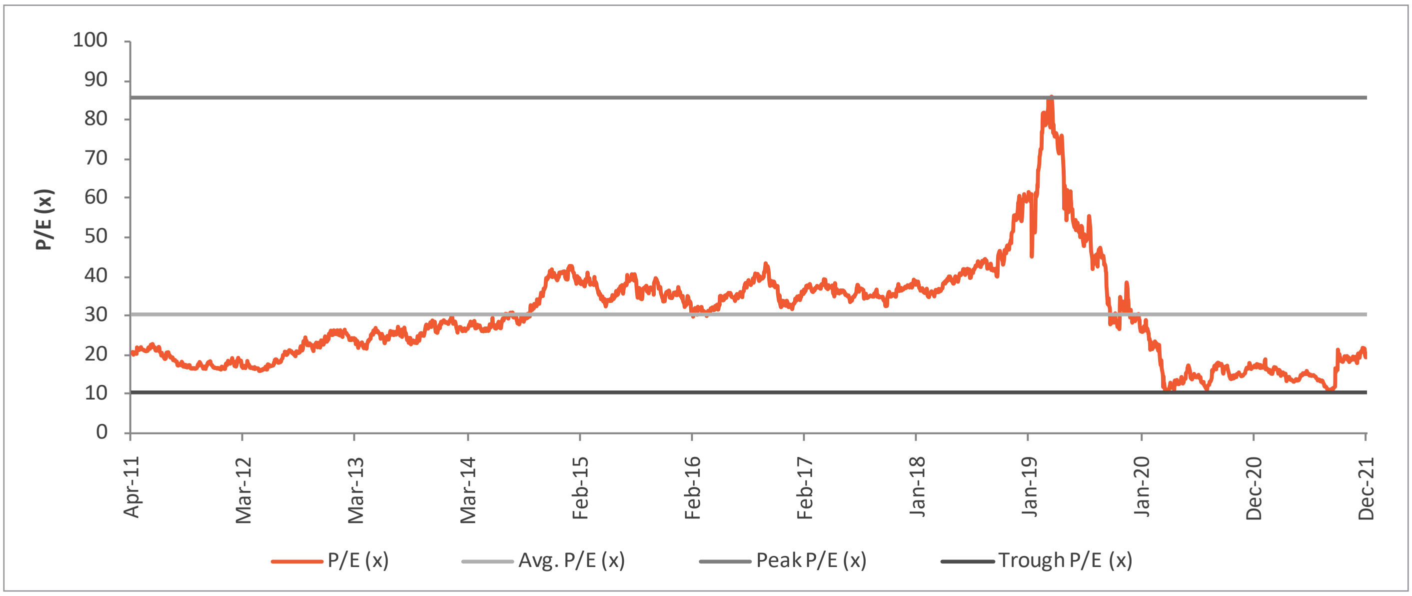
■ Company outlook - Potential merger would enhance reach potential

ZEEL is one of India's leading M&E companies, primarily engaged in broadcasting, movies and music production and digital business. The company has a strong presence in the GEC segment, given deep regional penetration, and has expanded its presence in the movie genre with the launch of new channels. The merger is expected to strengthen ZEEL's portfolio with Sony's sport, kids, and English movie content. The combined entity will be in a superior position on maximising its revenue across platforms, including OTT, given its wider content choices, investments on digital, aggressive bidding for sports rights, and focus on leveraging Sony Group's deep capability in gaming and presence in international markets.

■ Valuation - Merger likely to address multiple issues

Merger to improve long-term prospects: We believe the merger will strengthen the market position of the combined entity and help to grow OTT at a faster pace by allocating growth capital towards premium content, including sports rights. Further, the strong board and proven operational track record of Mr. Puneet Goenka will enhance the combined entity's competitive position in markets, which would drive its revenue and profitability as well. We believe corporate governance concerns will get addressed with the controlling stake of SPNI. The stock is currently trading at a reasonable valuation at 21x/19x its FY2023E/FY2024E earnings. The stock price of ZEEL has provided a return of 104% over the past four months. Hence, we maintain our Buy rating on ZEEL with an unchanged PT of Rs. 400.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

ZEEL is one of India's largest vertically integrated M&E companies, primarily engaged in broadcasting and content development with the widest language footprint, movies and music production, live events, and digital business. The company is amongst the largest producers and aggregators of entertainment content in the world, with an extensive library housing over 2,50,000 hours of television content. ZEEL houses the world's largest Hindi film library with rights to more than 4,200 movie titles from foremost studios and of iconic film stars. Through its strong presence worldwide, ZEEL is present across 170+ countries and has a reach to over 1.3 billion viewers.

Investment theme

The company has delivered a strong revenue CAGR of 8% over FY2015-FY2021 despite strict lockdown restrictions owing to outbreak of COVID-19 in FY2021. ZEEL's management remains confident of delivering advertising revenue growth, ahead of the industry's growth rate. Hence, the company is considered as one of the leading players under the structural India consumption theme. The proposed merger with SPNI will create the largest media company in India across languages and genres, with around 25% market share.

Key Risks

Unfavourable regulatory guidelines impacting subscription revenue, slowdown in the economic environment leading to lower demand, and subdued realisation for advertisement revenue stream. Delay in monetisation benefit from digitisation and increased investments in ZEE5 could affect earnings.

Additional Data

Key management personnel

Punit Goenka	Managing Director and CEO
Amit Goenka	President - Digital Businesses & Platforms
Anurag Bedi	Chief Business Officer – Zee Music
Rohit Kumar Gupta	Chief Financial Officer
Ashish Agarwal	Chief Compliance Officer & Company Secretary

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Invesco Limited	17.89
2	OFI GBL China FD LLC	10.14
3	Invesco Oppenheimer	7.74
4	Blackrock Inc	5.01
5	Life Insurance Corp of India	4.89
6	The Vanguard Group Inc.	4.83
7	Amansa Capital Private Limited	4.38
8	HSBC Holding PLC	3.58
9	Nippon Life India Asset Management	2.50
10	Norges Bank	2.47

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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